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FINANCIAL RELATIONS

BETWEEN THE

GOVERNMENT OF INDIA

AND THE

PROVINCIAL GOVERNMENTS.

PARTS C TO J

FINANCIAL RELATIONS BETWEEN THE GOVERNMENT OF INDIA AND THE PROVINCIAL GOVERNMENTS.

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C.—EXPENDITURE.

Position before the Reforms.

35. The following are the stages in the devolution of powers of expenditure by the Secretary of State:—

(1) Section 41 of the Government of India Act, 1858, which regulated the expenditure of Indian revenues, ran as follows:—

> "The expenditure of the revenues of India, both in India and elsewhere, shall be subject to the control of the Secretary of State in Council; and no grant or appropriation of any part of such revenues, or of any other property coming into the possession of the Secretary of State in Council by virtue of this Act, shall be made without the concurrence of a majority of votes at a meeting of the Council."

The entire responsibility for the control of expenditure from Indian revenues was thus vested by the statute in the Secretary of State in Council. In order, however, to provide for the more speedy transaction of public business, the Secretary of State from time to time prescribed limits within which expenditure might be incurred by the Government of India without previous reference to him on each occasion. These restrictions before 1889 were embodied in executive orders, rules and regulations issued by the Secretary of State.

(2) In 1889 for the first time a Resolution was issued indicating precisely the limits of expenditure which the Governor General in Council could incur without previous reference to the Secretary of State. Under this Resolution which was re-issued with certain modifications in 1893, the sanction of the Secretary of State was required for—

(*a*) the creation of an appointment of which the salary exceeded £200 a year;

(*b*) the raising of the salary of an existing appointment to an amount exceeding £333 a year;

(*c*) the revision of an establishment at a cost of more than £1,667 a year;

(*d*) the incurring of expenditure which under any of the various codes required the Secretary of State's sanction;

(*e*) the construction of a public work from borrowed funds;

(*f*) the construction of a public work charged to revenue which was estimated to cost more than £83,000; and

(*g*) the construction of any railway except short additions of local interest.

It was then understood that by this Resolution the Secretary of State in Council had formally *delegated* the authority entrusted to him for expenditure in India except in cases where he had by special order or by established practice reserved to himself the exercise of that authority.

(3) In 1908, when the Audit Resolution was under discussion, the constitutional position was elucidated. It was pointed out that the Secretary of State in Council had no power to divest himself of responsibility as regards expenditure and that he could not make any general assignment of his control. It was held that any such delegation of control, either to the Government of India or to any Province or body serving under it, would be an evasion of the spirit and infraction of the letter of the Act of Parliament. In the following year the powers of the Government of India and local Governments in respect of expenditure were extended.

(4) The question of further extension of these powers was examined exhaustively by the Royal Commission on Decentralisation, which was appointed in 1907 and as a result of their recommendations these powers were enhanced considerably.

(5) In 1916 the following proviso was added to section 41 of the Government of India Act, 1858:—

"Provided that a grant or appropriation made in accordance with the provisions or restrictions prescribed by the Secretary of State in Council with the concurrence of a majority of votes at a meeting of the council shall be deemed to be made with the concurrence of a majority of such votes."

This amendment defined more precisely the constitutional position as it had developed during the preceding years and legalised the delegation of power by the Secretary of State to authorities in India.

Control by the Government of India.

36. The control of the Secretary of State over the powers of expenditure of the

Government of India and Provincial Governments has so far been dealt with. As regards the powers of control of the Government of India over Provincial Governments, the constitutional position before the Reforms was briefly as follows:—

> Under Section 45 of the Government of India Act, every local Government was bound to obey the orders of the Governor General in Council and "to keep him constantly and diligently informed of its proceedings in all matters which in its opinion should be reported to him or as to which he requires information." Since the Government of India were generally responsible for provincial solvency, the financial control that was exercised was detailed as well as rigid and financial settlements were based definitely on the requirements of the various provinces. So far as provincial expenditure was concerned, the Provincial Governments exercised certain limited powers delegated to them by the Secretary of State.

Position under the Reforms.

37. One of the fundamental principles laid down by the authors of the Report on Indian Constitutional Reforms as the basis for the new constitution was that the provinces should be given "the largest measure of financial independence of the Government of India which is compatible with the due discharge by the latter of its own responsibility." This was to be effected partly by a complete separation of the sources of revenue and partly by a relaxation of the orders under which proposals for Provincial expenditure had to be submitted to the Secretary of State for his approval. The broad outlines of the procedure by which this object was to be achieved are indicated in paragraph 59 of the First Despatch of the Government of India on Indian Constitutional Reforms. They are briefly as follows:—

> (*a*) *Public Services.*—In regard to all-India Services, the Secretary of State should retain virtually all his then existing powers for the pay and strength of the cadres while abrogating them in regard to other Services. As regards subsidiary matters, such as temporary appointments, foreign service, allowances, leave rules, age of retirement, etc. broad fundamental regulations were to be laid down and all details were to be left to be administered in India in accordance with those regulations and under scrutiny of Audit. The scales and general conditions

as regards pensions were to be incorporated in rules framed under the Act.

(*b*) *Staff of Public Offices.*—All minor restrictions on the powers of Provincial Governments should be removed, subject only to the condition that the Secretary of State's approval should be obtained in cases where the outlay exceeded a high and definite pecuniary limit or, in the alternative, where certain fundamental principles of administration are involved.

(*c*) *Public Works.*—In regard to expenditure on public works, a high monetary limit should be imposed up to which works might be undertaken by Provincial Governments without reference to the Secretary of State.

(*d*) *High Officials.*—In regard to the amenities of High Officials, there should be no relaxation of the Secretary of State's control.

(*e*) In regard to expenditure of an unusual nature or devoted to objects outside the ordinary work of administration, certain canons of propriety were to be laid down to be enforced in India under the surveillance of audit.

(*f*) *Audit.*—There should exist a powerful and independent Central audit, which would bring financial irregularities and misdemeanour prominently before the executive and the legislature.

68. In pursuance of these decisions, rules were drafted by the Government of India and submitted for the approval of Parliament. The principal features of these rules were as follows:—

(*a*) The rules included what are now known as the canons of financial propriety.

(*b*) No attempt was made to separate the rules relating to transferred and reserved subjects.

(*c*) The rules in respect of transferred subjects imposed restrictions on the creation of appointments in the cadre of an all-India Service, on the creation of temporary appointments, on the grant of pensions, on the grant to officers of allowances, etc. not admissible under rules made under Section 96-B. The rules as regards expenditure on reserved subjects raised the limit of expenditure on irrigation schemes to Rs. 50 lakhs and on revisions of establishment from Rs. 50,000 to Rs. 15

lakhs.) These restrictions were retained so as to ensure, in the case of the largest irrigation works, that the most competent expert advice was enlisted in their preparation, and in the case of revisions of establishment because some revisions might affect other provinces.

(*d*) No sanction was valid without appropriation.

39. The Joint Select Committee, which revised these draft rules, made very important alterations.*

(*a*) In the first place, they considered it essential to draw a clear distinction between the powers of a Provincial Government to sanction and incur expenditure on transferred subjects and its powers in relation to expenditure on reserved subjects.

(*b*) In the second place, they considered it unnecessary and undesirable to prescribe by statutory rules the extent to which the Secretary of State in Council was prepared to delegate to Provincial Governments his powers of control over expenditure on reserved services. They recommended that such delegation should, as in the past, be by means of executive orders made in virtue of the power conferred by the proviso to section 21 of the Act.

(*c*) The rules relating to transferred subjects (Schedule III to Devolution Rules) imposed restrictions only on the creation of appointments ordinarily held by members of all-India services, on the creation of temporary posts carrying a salary exceeding Rs. 4,000 a month and on the grant of allowances and pensions not admissible under rules framed under Section 96-B. Subject to these limitations, Ministers were to be as free as possible from external control, and the control to be exercised over expenditure on transferred subjects was to be exercised by the provincial legislature and by that body alone.

(*d*) The portion of the Government of India's draft containing the canons of financial propriety was omitted, because the Committee considered that it would be constitutionally impossible for the Secretary of State to take

*(Report of the Joint Select Committee on the Draft Rules made under the Government of India Act.)

power in the rules which he is to frame to intervene in the administration of transferred subjects for the purpose of securing compliance with these canons and it would be inappropriate to lay down conditions in these rules which, so far as the Ministers were concerned, there would be no power to enforce. They recommended that the substance of these rules should be incorporated in the rules to be framed by the Secretary of State in Council under Section 39 of the Act for the purpose of prescribing the duties of the Auditor General, that the duty should be specifically laid upon that authority of conducting his audit with reference to these canons and that any breach which he detected should be brought promptly to the notice of the local Government and of the Committee on Public Accounts. The Committee also stated that it would be the duty of the Legislative Council to rectify irregularities of this description, and the manner in which notice had been taken of reports of the Auditor General would be an obvious point to which the Parliamentary Commission would be likely to direct its attention.

40. The introduction of the Reforms has therefore had the result of transferring the control over expenditure in respect of transferred subjects from the Secretary of State and the Government of India to the Legislative Councils, except in the case of all-India Services. The powers of expenditure of Provincial Governments in respect of reserved subjects have been defined in a Resolution of the Secretary of State in Council, commonly known as the Provincial Audit Resolution. The restrictions that have been imposed are similar to those that apply to transferred subjects, but the Secretary of State has retained control in respect of capital expenditure on certain schemes and extensive revisions of establishment involving heavy expenditure. So far as the Government of India are concerned, there is practically no control over Provincial expenditure. They can merely offer their advice or their comments in forwarding schemes for the sanction of the Secretary of State.

41. There has been a further devolution of power since the introduction of the Reforms. The Royal Commission on the Superior Civil Services in India recommended that Provincial Governments should be given control not only over the newly Provincialised services in the transferred Departments but over all Provincial Services. Under the Civil Services Delegation Rules

of 1926, Provincial Governments have now complete power to make rules regulating the method of recruitment, conditions of service, pay, allowances, pensions, etc., of Provincial Services, subordinate Services and special posts.

42. It will thus be observed that control over provincial expenditure is now limited to—

(*a*) the pay, allowances etc., of all-India Services,

(*b*) the expenditure of the Provincial Governors,

(*c*) revisions of establishment in the reserved subjects involving an annual expenditure exceeding a certain limit, and

(*d*) capital expenditure upon irrigation and navigation works, including docks and harbours, and upon projects for drainage, embankment and water storage and the utilisation of water-power, where the original estimate exceeds Rs. 50 lakhs.

The question of the retention of control in respect of the first two cases raises administrative and constitutional issues, the decision on which must depend on considerations other than financial. It is therefore not proposed to deal with them here. The degree of control that should be exercised by the Secretary of State and the Government of India over irrigation has been a subject of discussion for several years. Nominally this control rests with the Secretary of State in Council, whose sanction is required to these projects, but actually, since he maintains no advisers on irrigation matters, he exercises the control through the Government of India through whom the estimates are submitted to the Secretary of State. The Government of India, however, have experienced considerable difficulty in exercising effective control, for the following reasons :

(1) In the first place, Provincial Governments are now financially responsible for their irrigation works and the revenue accruing from them forms part of their resources. No new work can be initiated unless and until a demand for the grant of necessary funds has been submitted to the local Legislative Council.

(2) In the second place, the efficiency, both technical and financial, of an irrigation project depends upon points of detail as well as upon the general wide conception of the scheme, and Provincial Governments are, not unnaturally,

somewhat reluctant to accept advice on points of detail from outside authorities who cannot claim to possess any local knowledge. Nor are the Government of India in a position to ensure that they are put in possession of all the facts necessary for the formulation of a correct opinion.

43. There are two possible ways of dealing with the present position—

(*a*) Irrigation might be included in the list of Transferred subjects. This alternative, however, raises issues of an administrative character, and the question need not therefore be discussed here.

(*b*) The limitations imposed by the audit resolution might be deleted and the present detailed technical control of the Secretary of State and the Government of India abandoned.

The question was discussed at great length with the Provincial Governments who were generally inclined to accept the second alternative, provided efficient machinery was created to prevent any province from launching upon a project likely to be detrimental to the best interests of any other province. Most of them considered that a second professional opinion on technical questions should be made available to them. It was suggested that a possible solution would be the formation of a Central Irrigation Board of Provincial Chief Engineers together with the Consulting Engineer to the Government of India, whom the Provincial Governments could consult whenever a new project was about to be sanctioned. Under the new system, on the application of a Provincial Government, the Government of India would convene a sub-committee of this Board consisting of Chief Engineers who have had recent experience of works akin to those to be discussed, who would advise the local Government concerned on the questions at issue. The local Government asking for the Board would pay the travelling and halting allowances of its members; but their pay would continue to be borne by the Government to which they belonged, which would obtain in return the right to call for a Board whenever it required. It would be obligatory for a local Government

to place all new projects the estimated cost of which would be Rs. 50 lakhs or over before the Board for advice on their technical aspects.

44. A Central Irrigation Board for advisory purposes has been functioning since 1927, but the Secretary of State has not divested himself of control over expenditure on irrigation schemes. Even if irrigation were transferred, it is a question for consideration whether such a Board should not be retained not only in the interests of the provinces themselves, but also to deal with schemes that affect more than one province or an Indian State.

D.—PROVINCIAL BORROWING.

45. Before the Reforms, local authorities such as Port Trusts and the larger municipalities were allowed, subject to certain restrictions, to borrow small amounts in the open market on local security. This right, however, was never accorded to the Provinces, partly because the revenues of India were legally one and indivisible and were liable for all debts incurred for the purposes of the Government of India, and Provincial Governments possessed no separate resources on the security of which they could borrow. This privileged position gave the Government of India an effective means of ensuring Provincial solvency and the right of detailed interference for this purpose.

46. Even as regards what was known as the Provincial Loan Account, the control was very detailed. The procedure observed was briefly as follows. Every year the Provinces submitted an estimate of their requirements for the following year in respect of loans to cultivators and to municipal and other authorities. The Government of India provided the net amount after making such reductions as were necessary on account of their borrowing programme for the year.' The principal features of the working of the system are described below :—

(1) The purposes for which local authorities might borrow were laid down in an all-India Act (Local Authorities Loans Act, 1914). The minimum rate of interest and the maximum period of re-payment for loans were fixed from time to time by rules under the Act, but the Provincial Government was allowed, without reference to the Government of India, to remit the payment of interest, to postpone an instalment due in repayment of capital, to write-off any bad debt and to charge a penal rate of interest on arrears.

(2) Loans to cultivators were regulated by another Act, but on similar principles. Provincial Governments were given complete freedom as regards the security for and the terms of these loans, except that they were bound to charge a higher rate of interest than that which they themselves paid to the Government of India. Maximum periods of repayment were prescribed by rules. The Provincial Governments normally charged a uniform rate of interest on all loans to culti-

vators. The difference between the rate of interest charged by the Government of India and that charged by the Provincial Governments to cultivators was credited to Provincial revenues.

(3) Repayments to the Provincial Loan Account in respect of previous loans were available to the Provinces for making fresh advances and the Provincial estimates were therefore based on net figures.

(4) Repayments to the Account were not taken into account in fixing the rate of interest to be charged on new advances made by the Central Government. The provinces were charged the same rate of interest as the Government of India had to pay for new money.

47. These severe restrictions were necessitated not only by the constitutional position but also by certain practical considerations. The total market for borrowing before the War was very limited and the British market was very sensitive. It was, therefore, necessary to control the total borrowings by one agency. If the Provincial Governments had independent powers of borrowing, there was a possibility of the rates being forced up and the market dislocated and credit possibly impaired by indiscreet ventures.

48. The question of relaxing the control of the Central Government was considered by the authors of the Report on the Constitutional Reforms, who came to the conclusion that if Provincial Governments were to enjoy such real measure of independence as would enable them to pursue their development policy, they must be given some powers, however limited, of taking loans. They recognised the impossibility of allowing Provincial Governments to compete with the Government of India in the open market but emphasised the importance of the principle that, as far as possible, the Central Government should regard an application for a loan "solely from the standpoint of finance and not from that of administration and that if it had the money and was satisfied with the arrangements for financing the loan, it should not withhold sanction."* They came to the conclusion, however, that, in order to avoid harmful competition, Provincial Governments must continue to do their borrowing through the Government of India. If the Central Government found itself unable to raise sufficient money to meet all the demands of the Provinces in any particular year, a fair and

*Report on Indian Constitutional Reforms, paragraph 211.

equitable distribution between the Provinces should be made by a small committee on which the Central and the Provincial Governments were represented. They also recommended that if the Central Government was not able to raise the money and if there was good reason to believe that a Provincial project would attract money which would not be elicited by a Government of India loan, the Provincial Government should be allowed to have recourse to the Indian market subject to the approval of the Government of India to the method of borrowing, including the rate of interest, etc.

49. These proposals were subjected to considerable criticism by the Provincial Governments, some of whom desired unrestricted power of raising loans for Provincial purposes and most of whom objected to any scrutiny by the Central Government of the purposes for which a Provincial loan was raised or required. The Government of India, however, expressed their concurrence with the proposals in the report on constitutional reforms. They stated that the temporary unproductive debt which had to be redeemed or funded during the years 1918 to 1928 amounted to £75 millions, which was a very big figure for the Indian market. There was also the certainty of heavy borrowings for railway development. Their detailed proposals were briefly as follows :—*

(1) Priority should be given to loans required for famine relief and for financing the Provincial Loan Account.

(2) Apart from these special cases, Provinces should not borrow except for capital purposes.

(3) Establishment of sinking funds should be prescribed at least in the case of unproductive debt.

50. The rules that were framed in pursuance of these decisions underwent considerable changes during examination by the Joint Select Committee, who considered that loans raised in India should be differentiated from those raised in the United Kingdom for the purpose of prescribing the sanctioning authority and that the Government of India or the Secretary of State, as the case may be, should retain control over the effective rate of interest to be paid and the amount and form of the issue.† The restrictions imposed by the statutory rules (commonly known as the Local Government Borrowing Rules), as

*First Despatch on Indian Constitutional Reforms, paragraph 62.

†Second Report of the Joint Select Committee on Draft Rules under the Government of India Act, paragraph 3.

revised by the Joint Select Committee, may be summarised as follows :—

(1) The purposes for which loans may be raised were specified, the purposes being—

(*a*) to meet capital expenditure.

(*b*) to meet any class of expenditure on irrigation which was previously met from loan funds,

(*c*) for famine relief and relief works,

(*d*) for financing the Provincial Loan Account, and

(*e*) for repayment and consolidation of loans raised, or repayment of advances made by the Central Government.

(2) No loans can be raised by a Local Government without the sanction of the Governor General in Council or, in the case of a loan to be raised outside India, of the Secretary of State in Council.

(3) In sanctioning the raising of a loan, the Central Government or the Secretary of State may specify the amount of issue and any or all of the conditions under which the loan shall be raised.

(4) Interest on the loans raised is a prior charge on the revenues of the Provincial Government subject to certain exceptions.)

51. The most important development since the Reforms in the relations between the Central Government and the Provincial Governments so far as borrowing is concerned is the establishment of the Provincial Loans Fund. The main object of the scheme, which was introduced in 1925, was to regulate the terms and conditions, the rate of interest and the period of amortisation of all advances made by the Central Government to the Provincial Governments. The salient features of the scheme are briefly indicated below :—

(1) The Fund is intended to be self-supporting and independent of the debt of the Central Government. All advances to Provincial Governments are made through this Fund, to which have also been transferred all the capital liabilities of the Provincial Governments to the Government of India on the date of the establishment of the Fund.

(2) The Fund is worked on the principle that if a Provincial Government makes suitable arrangements for the payment of

interest and amortisation, money will be made available from the Fund to the full extent of the province's requirements. The Government of India will normally refrain from scrutinising the purposes for which loans are required by the province, the selective influence being provided by varying the terms of interest and repayment according to the object for which the money is borrowed. The rate of interest charged by the Central Government on advances to the Fund is determined on the basis of the cost of new borrowing, but the rate of interest charged for advances made out of the Fund to Provincial Governments varies according to the nature of the scheme for which the loan is required. The standard rate of interest calculated on certain principles is charged on all advances required for capital expenditure which could be classed as productive. For all other advances the rate is ¼th per cent. above the standard rate. Under the rules regulating the Fund no advances can be made out of the Fund unless the Provincial Government provides annually out of its ordinary revenue from the date of borrowing a sum sufficient to redeem it within a period not exceeding eighty years.

(3) The Fund does not affect the right of provinces to borrow in the open market subject to the conditions laid down in the Local Government Borrowing Rules, and the Government of India retain full power to refuse or suspend advances to the Fund, if the financial position of India renders such a course imperative.

52. Such in brief is the present position. The question might arise whether if the Provincial Governments were made financially autonomous or if the present system of allocation of revenues were abandoned and provincial revenues were vested in the Provincial Governments, it would be necessary to retain any of the restrictions now imposed on the borrowing powers of Provincial Governments. If any such development should take place the question might still have to be considered whether co-ordination of the borrowing activities of Provincial Governments would not be necessary in the interests of the provinces themselves and of India as a

whole. The following are considerations bearing on this question :—

(*a*) In the first place, the provinces would get money at a cheaper rate if it were borrowed on the combined credit of the provinces and the Government of India. The following statement compares the rate of interest at which Provincial Governments were able to borrow money in the open market with the rates for the Government of India loans raised in the same year. It will be observed that the effective rate of interest on provincial loans is higher in every case than the corresponding rate for the Central Government loans.

Statement comparing the rates of Interest paid by the Provincial Governments on loans raised from the Public with the corresponding rates paid by the Central Government.

Provincial loans.	Amount in lakhs of rupees.	Effective rate of interest per cent.	Rate of interest on the Government of India loans in the same year.	Difference in interest per cent.	Net loss per annum, in the shape of interest in lakhs of rupees.
The Bombay Development Loan, 1920	9,39	7·13	6·57	0·56	5·26
The United Provinces Development Loan, 1921.	4,20	7·36	6·57	0·79	3·32
The Punjab Development Loan, 1923	1,92	6·26	5·88	0·38	0·73
The Punjab Development Loan, 1925	89	5·76	5·48	0·28	0·25
				Total ..	9·56

(*b*) In the second place, it would seem to be very undesirable for the Government of India and the Provincial Governments to compete against one another in the open market as regards their loan operations.

(*c*) In the third place, Bombay and Calcutta are the two principal money markets of India and other provinces would be at a disadvantage in raising money at these two cities.

It is therefore a question for consideration whether even if complete provincial financial autonomy were conceded, it might not be desirable for the Provincial Governments and the Government of India to borrow money on a system of co-operation through a common agency. This would seem particularly advantageous in

the case of loans raised outside India. Appended to this Memorandum is a note describing a scheme worked out in broad outline by the Finance Department of the Government of India for the constitution of a body of National Debt Commissioners for India, which it is suggested might be entrusted with the work of investing the various funds now deposited with the Government of India and also with the management of the borrowing operations of the Provincial Governments. (See Appendix I). If such a body were constituted the Central Government would ordinarily raise its loans through the Commissioners or in consultation with them. The scheme has not yet been examined by the Government of India as a whole and they are not committed either to the principle underlying it or to the detailed propositions. It may be noted in this connection that a Loan Council consisting of representatives of Commonwealth and State Governments has recently been constituted in Australia to deal with all borrowing for both Commonwealth and States.

53. A brief reference may here be made to a question which has been the subject of controversy ever since the introduction of the Reforms, viz., the justification for payment of interest by Provincial Governments on capital expenditure incurred by Government upon the construction of protective irrigation works before the Reforms. Under Devolution Rule 24, the capital sums so spent by the Governor-General in Council on works that have been handed over to the management of Provincial Governments are regarded as advances made to the Provincial Governments from the revenues of India and interest is paid by the Provincial Governments on these sums.* When the question was under discussion in 1919, the Government of the Central Provinces protested very strongly against the proposal, on the grounds that the works were constructed out of revenue (mostly out of Famine Insurance Fund Grant) and not out of loan funds and that they were not remunerative. The Government of India urged that the levy of interest charges was justified since—

(1) the money spent out the Famine Insurance Grant on these works would otherwise have been available for the productive works programme, and

(2) the protective irrigation works might later become productive.

The provincial point of view was laid before the Meston Committee, the Secretary of State and the Joint Select Com-

*Devolution Rule 24 (1).

mittee, who all agreed with the Government of India.

54. The question was discussed at the Conference of Financial Representatives in 1922, but it was decided that there was no justification for a change in the system until the provincial contributions had been entirely remitted.

(E.—REMITTANCE AND RESOURCE ARRANGEMENTS.)

55. The questions of the control over the resources (taxation and borrowing) of Provincial Governments and over their powers of expenditure have been dealt with in the preceding sections. The working of the financial machinery by which provinces are kept supplied with funds during the year at the numerous paying centres in India and in England, sufficient in all cases to meet immediately the local demands on them, and by which the accounts of all Government transactions are compiled and audited, brings the Central Government into contact with the Provincial Governments at numerous points; and in order to avoid friction being engendered and to ensure the smooth working of the mechanism, certain powers of control in respect of these matters have been vested in the Central Government and the Secretary of State. These powers are briefly described below :—

(1) (Under Rule 16 of the Devolution Rules made under Section 45A. of the Government of India Act, the Governor General in Council is the sole custodian of the public account, into which are paid all monies derived from sources of provincial revenue. He has also the power, with the previous sanction of the Secretary of State in Council,) to prescribe by general or special order the procedure to be followed in the payment of monies into and (in the withdrawal, transfer and disbursement from the public account, and for the custody of money standing in the account.)

(2) (Under Rule 21 of the Devolution Rules, the Governor General may, at any time when he considers such a course essential in the financial interests of India as a whole, require any local Government so to regulate its programme of expenditure as not to reduce the balance at its credit in the public account on a specific date or dates below a stated figure.) He also has the power to take the necessary steps by the restriction of issues of money to secure this end.

(3) (Under item 15, Schedule I, Part I of the Devolution Rules, the Indian Audit Department, which compiles and audits the accounts of the transactions of the Provincial and Central Governments, is a Central subject.)

(4) Section 96D of the Government of India Act provides for the appointment by the Secretary of State of an Auditor General in India who is in some respects independent both of the Central Government and the Provincial Governments. This official has been entrusted, by rules made under the same section, with the duty of auditing all expenditure in India and also of compiling the Finance and Revenue Accounts of India. He has been given the necessary power to enable him to discharge his statutory functions as well as certain administrative powers over the Indian Audit Department.

56. For an adequate discussion of the various issues that have arisen during the last eight years in connection with the exercise of these powers, it is necessary briefly to describe the very complicated financial system that has been gradually evolved in the course of the last fifty years or more. At the headquarters of each district in India, there is a Government treasury, usually called the district treasury, which has under it several sub-treasuries distributed throughout the district. Into these treasuries and sub-treasuries, which number over 1,500, are paid the entire public receipts of the Government of India as well as of the Provincial Governments and from them are made all the payments on behalf of all the Governments. They are, however, wholly under the administrative control of the Provincial Governments, who also bear the entire cost of the establishment. In places where there is a branch of the Imperial Bank of India, the treasury business is conducted for Government by the bank. There is nothing in the Indian arrangements corresponding to the system of exchequer issues in England which effectively prevents the spending authorities from getting possession of more money than Parliament has granted them. There is no periodical issue of credits to the various Departments, and provided orders for payment are issued by authorised Government officials, the bank or the treasury, as the case may be, makes the payments, without enquiring whether the grant has been exceeded.

Compilation of accounts.

57. The process by which these receipts and payments are consolidated into the "Finance and Revenue Accounts of the Government of India" annually presented by the Secretary of State to both Houses of Parliament is briefly described below* :—

(a) The receipts and payments made at the treasuries are compiled

*The description of the accounting system is taken from Pritchard's "Introduction to Indian Government Accounts" and the Account Code.

at each district treasury into a monthly account which is sent to the provincial Accountant General. In the case of certain large departments, however, *e.g.*, the Railway, Military, and Posts and Telegraphs, payments are made into the treasury through the departmental officers, who also draw money by cheques or otherwise from the treasury. These departmental officers send the monthly detailed accounts of their transactions with the treasuries to their own Accounts and Audit officers and not to the provincial Accountants General. At this stage so far as treasury transactions are concerned, no distinction is made between Central and Provincial items.

(*b*) The next stage in the process is the classification of these receipts and payments under the appropriate heads of account. A certain amount of classification work is done at the treasuries and departmental offices, but the bulk of the accounting work including the consolidation of the accounts is done at the offices of the provincial Accountants General and other Accounts and Audit offices.

(*c*) Then comes audit which, as regards receipts, is confined to seeing that all sums receivable by Government are duly received and recorded. The audit of receipts is mainly done by the revenue authorities concerned. As regards expenditure, apart from the limited preliminary check applied at the treasury, the audit is conducted by trained audit officers (civil, railway, military, etc.), who with the aid of large staffs scrutinise expenditure over its whole extent and see that it is in accordance with the elaborate codes, sanctions and orders framed for its regulation.

(*d*) The last stage is compilation. The monthly accounts received from the treasuries and departmental officers and already classified and audited are compiled into consolidated monthly accounts of provinces, railways, military districts and other audit circles. Extracts of the Civil, Posts and Telegraphs and Railway accounts are submitted to the Controller of the Cur-

rency, who consolidates them month by month. The functions of this officer will be presently described.

The accounts of receipts and payments occurring in England, which are controlled, audited and finally booked against the respective Governments and heads of accounts in the offices of the Secretary of State and the High Commissioner for India, are also sent to India. The Auditor General consolidates the annual accounts of all public offices in India as well as the accounts of transactions in England into one annual account for the whole country. This account is presented by the Secretary of State to both the Houses of Parliament and is called the "Finance and Revenue Accounts of the Government of India."

(Ways and Means.)

58. As has already been explained, the Central Government is the sole custodian of the cash balances of all the provinces and on it therefore devolves the duty of maintaining a cash balance at all times during the year, both in India and in England, sufficient to meet the demands on the Provincial and the Central Governments. These cash balances include not only the revenues of these Governments but also—

(1) the large amounts borrowed by Government for capital expenditure on railway and irrigation ;

(2) the 'unfunded' debt of India, a term which is applied to a large number of interest-bearing obligations consisting of funds deposited for various purposes, such as—

(*a*) Service Funds,
(*b*) Post Office Savings Bank deposits,
(*c*) Post Office Cash certificate receipts,
(*d*) Provident funds,
(*e*) Postal Insurance and Life Annuity Funds, etc.

(3) various statutory and other funds on which the Government of India have to pay interest, such as—

(*a*) the Famine Insurance Fund,
(*b*) depreciation, etc., funds of certain commercial departments ;

(4) certain deposits, such as—

(*a*) the deposits of local bodies,
(*b*) departmental and judicial deposits, and various other accounts in regard to which the Government acts as banker, remitter, borrower or lender.

These balances, it may be noted, are utilised not only for meeting the ordinary

cash outgoings but in part also for financing the capital programme of the Government of India and for advances to the Provincial Loans Fund.

59. The process by which an adequate cash balance is maintained at the numerous treasuries and sub-treasuries scattered all over the country is briefly as follows :—

A forecast is first made of the opening balances of the year and of the monthly incomings and outgoings of all kinds belonging to the Central Government and all the Provincial Governments. By raising a loan or by reducing the amount proposed for expenditure, the estimated Government balance is normally never allowed to fall below a minimum figure. The method by which this cash balance is distributed between the numerous sub-treasuries all over the country so that each shall have at all times sufficient funds to meet the demands on it is much more complicated and it is very closely connected with the working of the Indian Paper Currency Act. Under the provisions of this Act, the amount of currency notes in circulation at any time may not exceed in value the amount of coin, bullion and securities held in the Paper Currency Reserve by the Secretary of State for India and the Government of India. The Security Reserve consists of securities held by the Secretary of State in England and securities held by the Governor General in Council, which latter are kept in the custody of the Controller of the Currency. A portion of the metallic reserve is kept partly in currency offices and partly in what are called currency chests which are maintained at every district treasury and a large number of sub-treasuries. The object of maintaining these currency chests, which are a peculiar feature of the Indian system, is to prevent money being unnecessarily locked up in treasury balances and to facilitate the transfer of funds as explained below:—

> "Notes held in a currency chest are not in circulation within the meaning of the Indian Paper Currency Act, while coin held in a currency chest is part of the reserve held by Government against notes that are in circulation. Assuming that there are no transactions elsewhere, the deposit of notes in a currency chest decreases the amount of notes in circulation and the deposit of rupees in a currency chest increases the amount of coin in the Paper Currency Reserve. A deposit of coin or notes in a currency chest thus enables Government to issue notes elsewhere up to the amount of the deposit without exceeding the limits of circulation laid down by the Act. If, therefore, a transfer of funds

from the treasury balance at A to the treasury balance at B is required, this can be effected at short notice and without the actual remittance of coin or notes by transferring money from the treasury balance to the currency chest at A and transferring the same amount from the currency chest to the treasury balance at B. In this way transfer of funds between places where there are currency chests is effected without the actual remittance of coin or notes; and this is the normal method of putting branches of the Imperial Bank of India, treasuries and sub-treasuries in funds and removing surpluses accumulating thereat to headquarters. The stock of currency notes and coin kept in a currency chest varies according to the needs of the respective districts. Remittances are made periodically from currency chests to Currency Offices and *vice versa* in order to keep the stocks at the necessary figure."*

60. The policy of the Government has been to reduce the balances at these sub-treasuries to the smallest amount possible. By the provision of currency chests at sub-treasuries, by the extension of power to selected sub-treasury officers to withdraw funds without previous sanction and by encouraging treasury officers generally to reduce their balances by making use of the facilities for remittance provided by these chests, the balances at Government treasuries have been economised to an amazing extent. During the year 1927-28 the average aggregate balance at all the 1,500 treasuries and sub-treasuries was only Rs. 2.30 crores and in only one month during the year was it over Rs. 2½ crores.†

61. The Imperial Bank of India is responsible for the provision of funds at its branches which, as has already been explained, do treasury work on behalf of the Government. The Controller of the Currency keeps in the Government account at the Imperial Bank of India a sum sufficient to enable the bank to meet Government disbursements at all its branches, but the detailed distribution of this sum among the branches is left to the authorities of the Bank. To facilitate remittances to England, the bulk of the balances at the Imperial Bank of India is held at the principal commercial centres from which normally remittance operations are made. Unlike the balances at Government treasuries, the balance at the Imperial Bank of India varies considerably from month to

*Para. 105 "An Introduction to Indian Government Accounts," page 53.

†Annual Report of the Controller of Currency, 1927-28.

month and also from year to year, for the Imperial Bank balances are utilized not only for ordinary disbursements but also for certain currency operations. For instance, the balance in July 1926 was over Rs. 36 crores, while in March 1928 it was as low as Rs. 6 crores. The average balance in 1926-27 was Rs. 10.99 crores while in 1927-28 it was only Rs. 10.56 crores.*

62. The provision of adequate cash balances in India has so far been dealt with. The provision of funds in London to meet the very large payments which the Secretary of State for India has to make in England is also an important part of the ways and means operations of Government, and the process by which it is made is very closely connected with the currency operations of the Government of India. Until recently the Secretary of State kept himself supplied with funds by the sale of what were commonly known as 'council bills' and by means of telegraphic transfers payable at Calcutta, Madras or Bombay. The annual exports from India being normally in excess of its imports, ordinarily there has usually been a large demand from the public for remittance of funds from England to India. Partly to meet this demand and partly to provide himself with funds to meet the large payments he had to make in England on behalf of the Central and Provincial Governments, the Secretary of State sold these council bills and telegraphic transfers payable in India against funds supplied to him in England. This system, however, has now been discontinued and the requirements of the Secretary of State and the High Commissioner are met by the purchase of sterling by the Government of India in India from banks and firms on an approved list. These banks and firms arrange with their London agents by cable for the payment of the sterling purchased by the Government to the Imperial Bank of India in London for credit to the account of the Secretary of State at the Bank of England. The rupee payments made by the Government are met from their treasury balances with the Imperial Bank of India.

63. The Secretary of State does not make any monthly forecast of his requirements but intimates by cable at irregular intervals the amounts of money that should be remitted. The amounts required are remitted by the Controller of the Currency, provided exchange is not unfavourable and the Government balances in India are adequate. If, however, the rate of exchange is very low, remittances are not infrequently made through the medium of

*Reports of the Controller of Currency, 1926-27 and 1927-28.

the Paper Currency Reserve. As has been pointed out in an earlier portion of the Memorandum, a portion of the Security Reserve is held in England and if monetary conditions render such a course desirable, these securities are sometimes transferred to the treasury balances of the Secretary of State, a corresponding amount in the shape of notes or coin being transferred to the Currency Reserve in India. For instance, in 1926-27, owing to various reasons, Government were not in a position to remit any large sums of money through the market. Consequently large transfers of sterling securities to the treasury balances of the Secretary of State had to be made. The amounts thus transferred through the Paper Currency Reserve aggregated nearly Rs. 23½ crores between April and December 1926. The amount held in the Paper Currency Reserve in the shape of sterling securities in England was Rs. 21 crores in August 1926 while there were no securities at all in the Paper Currency Reserve in England in June 1927. The present figure (15th June 1928) is Rs. 4¼ crores.

64. Remittances made to England are, however, not regulated entirely by the requirements of the Secretary of State. When the rate of exchange is very favourable and especially when it tends to reach the upper gold point, large amounts are remitted by the Government irrespective of the demands of the Secretary of State. In fact, the amount of monthly remittances varies considerably with the current rate of exchange. For instance, in 1927-28, the remittances in July and August were a little over one million pounds sterling, while in November, December and January, when the rate of exchange was very favourable, the amounts remitted aggregated £14¼ millions.*

65. The Government of India, as the custodian of the balances of the Provincial Governments, provide the funds necessary for payment on behalf of the Provincial Governments both in India and in England. The Provincial Governments make no remittances to England and all payments on their behalf are made by the Secretary of State and the High Commissioner and are adjusted in the final accounts. For the purposes of adjustment, the rate of exchange is generally taken to be the average rate during the month in which the payment was made and not the rate at which the Government of India remitted funds.

66. The Indian financial machinery of administration thus differs in several important respects from the English arrange-

*Reports of the Controller of Currency, 1926-27 and 1927-28.

ments. In England all the public balances and accounts are kept at the Bank of England and the machinery of financial administration is consequently highly centralised. All public receipts, ultimately reach the Bank of England and all original issues of public money are made from it. The question of ' resource ' therefore does not arise and even the problem of ways and means is simplified by being confined to revenue and expenditure proper and by the exclusion of debt and remittance which are separately dealt with.

On the other hand, in India a highly complicated system has become necessary, partly owing to the absence of a central bank and the undeveloped state of private banking and partly owing to the enormous area of the country and its huge population. The machinery that has been evolved is in many respects similar to that of one of the big modern banking organisations of Europe with its numerous branches scattered all over the country and with a highly centralised system of control from the head office. As has been observed, there are over 1,500 treasuries and sub-treasuries at which public receipts and payments occur. Corresponding to the fixed deposits of a bank, there are the Service Funds, the Provident Funds and various other funds on which Government pay interest. Similarly there are the Post Office Savings Bank deposits corresponding to the Savings Bank section of a bank. Corresponding to the current deposits, there are the revenues of Provincial Governments and local authorities and the departmental and judicial deposits on which normally no interest is paid. The Central Government also makes use of these deposits not only to finance its own capital programme but also to make advances to the depositors. Like a typical banker it receives deposits at a comparatively low rate of interest and relends the money—in some cases to the depositors themselves—at a higher rate. Just as a big banking organisation aims at reducing the surplus at its branches to a minimum and concentrates its balances at the head office and one or two branches where they can be most profitably utilised, the Central Government in India has also evolved an elaborate machinery by which the balances at the sub-treasuries and treasuries have been reduced to a very low figure. This assumption by the State of the functions of a banker and remitter has immensely complicated the problem of ways and means and the constant adjustment to each other of the fluctuating volumes of incomings and outgoings.

67. The system has on the whole worked efficiently, but it has sometimes been criti-

cised as cumbrous and defective, both from the constitutional as well as the financial point of view.) With the criticisms directed against the currency and exchange operations of the Government, this Memorandum is not concerned. (So far as the financial relations between the Central and Provincial Governments are concerned, the peculiarities which have evoked criticism are summarised below:—

(1) In the first place, the apportionment of the cost of administration between the Central Government and the Provincial Governments is not made on any logical basis. The treasuries and sub-treasuries, as has been pointed out already, deal with Central as well as Provincial transactions, but they are under the general administrative control of the Provincial Governments, who bear the entire cost of maintaining them.) Actually the Provincial Treasury Officer is under the control of the Controller of the Currency so far as resource arrangements are concerned and under the Accountant General for accounts purposes. Both these are officers of the Central Government. The Governor General in Council has also the power of issuing 'treasury orders' regulating the procedure to be observed at all the treasuries. The Central Government bears the entire cost of the compilation of accounts and of the arrangements for remittance and resource.

(2) (In the second place, the Central Government, except in certain cases ~~which will be referred to in a subsequent portion of this Memorandum,~~ allows no interest on the balances of the Provincial Governments or on the departmental and judicial deposits, which are all merged in the general balances) and are utilised not only for financing the capital programme of the Central Government but also for making advances to the Provincial Governments on which, of course, interest is charged. Even as regards certain deposits, such as the Famine Insurance Fund, on which the Central Government allows interest, the rate of interest allowed is normally lower than the rate of interest at which advances are made to the Provincial Loans Fund.

(3) (In the third place, under the present system of accounting no distinction can be made in the initial

stages between a payment on account of the Central Government and a payment on account of a Provincial Government. It is only after a considerable lapse of time that the accounts are separated. It is impossible, therefore, at any given time to say whether a province has an overdraft or a surplus in its banking account and it is only after the lapse of months that its exact position at the end of the financial year is ascertained.

68. Certain minor criticisms which need not be mentioned here in detail have also been levelled against the system, and the question has often been discussed during the last eight years whether the present cumbrous system could not be simplified and some of these defects removed by a decentralisation of the financial functions of the Central Government. It is a question for consideration whether decentralisation, if desirable at all, should be on a territorial basis or on a functional basis. If it is held that political considerations should outweigh considerations of a financial character and complete financial as well as administrative autonomy should be conceded to the provinces, decentralisation on a territorial basis would seem to be almost inevitable. It would, however, involve provincial responsibility for accounts, ways and means, remittance operations, provincial loans, etc., and would necessitate the maintenance of trained financial staffs at the headquarters of Provincial Governments. All these services would have to be paid for by the Provincial Governments. The latter method, *i.e.*, decentralisation on a functional basis, would be more in accordance with the development of non-governmental financial organisations. The tendency in all banking and other financial organisations is towards amalgamation and centralisation of control, which renders possible the employment of highly paid experts and reduces the overhead charges. From the purely financial point of view, it might be argued that a more effective method of simplifying the present system would be by the transfer of certain definite functions to specially constituted bodies such as a central bank, which would deal with currency and remittances and be in charge of all balances or a Board of National Debt Commissioners who would be entrusted with the work of borrowing and investment. It will be observed from a subsequent portion of the Memorandum that the tendency in most modern federations is towards centralisation rather than towards decentralisation.

69. Certain specific problems such as—

(*a*) the separation of provincial balances, and

(*b*) the separation of accounts from audit, which have arisen during the last eight years, will be dealt with in the succeeding Sections.

F.—SEPARATION OF PROVINCIAL BALANCES.

70. The separation of provincial balances has been urged partly on financial grounds and partly on grounds of a constitutional character. Under the rules in force immediately after the introduction of the reformed constitution, Provincial Governments were not entitled to any interest on their ordinary balances, which included loan funds. The Government of Bombay protested against this system and claimed interest on the temporarily surplus proceeds of the big loan that it had raised for development purposes. After some discussion, it was decided to make a distinction between ordinary balances and surplus loan funds on which the Provincial Governments were actually paying interest, and from June 1921 Provincial Governments were allowed interest on surplus loan funds equivalent to the current yield on treasury bills, provided an undertaking was given that these would not be withdrawn for a certain fixed period. No minimum amount or period was, however, fixed for such deposits.

71. The Provincial Governments were not entirely satisfied with this arrangement and claimed that the Central Government should in fairness pay interest on the whole of their balances and pressed for complete liberty to the provinces as regards the disposal of their surplus moneys whether by investment in securities of the Government of India or by deposits in approved banks. In answer to this it was pointed out that such a course was neither practicable nor constitutionally desirable. It was also urged that since the Central Government did resource and currency work for Provincial Governments, they were entitled to the free use of provincial balances. These services, however, have been rendered impartially to all provinces irrespective of the magnitude of their balances, and an obvious criticism of the arrangements in force was that they benefited Governments which had small balances or none at the expense of those which had large balances. After some discussion the principle was definitely recognised that a Provincial Government should in certain circumstances be allowed interest on its balances and the Devolution Rules were amended by the addition of the following sub-rule to rule 22 :—

> "The Governor General in Council may also pay to a local Government interest on its surplus balances on such conditions as he may, with the approval of the Secretary of State, prescribe."

72. There were, however, two practical difficulties in the way of the adoption of this principle.

(1) The first was to determine exactly the circumstances that would justify the payment of interest. To overcome this, the following arrangements have been made:—

(*a*) No interest is allowed on deposits unless the amount deposited is not less than Rs. 25 lakhs and the period of deposit is not less than 6 months at a time. In the case of Assam, however, owing to special circumstances, the minimum has been fixed at Rs. 10 lakhs.

(*b*) Interest is allowed at one per cent. less than the rate charged by the Government of India on advances to the Provincial Loans Fund during the period on deposits which are initially declared for 12 months and over and at two per cent. less for shorter periods.

(*c*) No interest is paid if the balance of a province after taking the fixed deposit into account is overdrawn for more than one-third of the period of the deposit. Withdrawals within the period are treated as temporary advances bearing interest.

(2) The second difficulty arose from the fact that under the system of accounting it is not easy to ascertain precisely the balance at the credit or debit of a Provincial Government on any given date. A scheme, however, was worked out by the Auditor General to overcome this difficulty. It is described in Article 298A of the Account Code.

73. From the constitutional point of view, it has been urged that the separation of provincial balances from those of the Central Government is an essential preliminary to an appreciable advance towards provincial autonomy. In fact, it is stated that, until a Government has its own separate balances, it cannot adequately realise the importance of financial considerations. The following advantages are claimed by advocates of this measure :—

(1) It would enable the Provincial Governments to know precisely whether they have an overdraft or a surplus in their banking accounts.

(2) With the separation of banking accounts, the Provincial Governments and their Finance Departments would for the first time be brought up against ways and means questions. They would then have to consider such matters as attempting to spread their expenditure over the year in such a way as to coincide with the periods when their revenue comes in. They would have to arrange for financing slack seasons of the

year when expenditure exceeds revenue, by obtaining accommodation from their bankers for the purpose. They would have to study the problems connected with the lending out temporarily of surpluses due either to such exceptional receipts as the issue of loans or to temporary periods of revenue exceeding expenditure. The separation would also compel the Provincial Governments and their legislatures, who at present are sheltered from the complexity of ways and means questions, to realise a fuller financial responsibility. In short, it is claimed that the separation is essential in order to educate the Provincial Governments in matters of high finance.

74. The theoretical and practical objections that might be urged to the proposal are summarised below :—

(1) In the first place, the provincialisation of accounts, (audit remaining a central subject), which is an essential preliminary to the introduction of the scheme, will involve heavy additional expenditure. It has been estimated that the extra cost will be at least Rs. 2 lakhs per annum for each province.

(2) In the second place, if provincial balances were separated, the ways and means programme, which is single at present, would have to be divided into ten portions, nine on behalf of the Provinces and the tenth on behalf of the Central Government. The combined balances after the separation of the banking accounts would almost certainly exceed the single balance now regarded by the Government of India as the necessary minimum. There would be ten margins to meet, as the case may be, instead of one as at present, and the Imperial Bank of India, with whom all Government monies would presumably be kept under the new scheme, would be the gainer.

(3) In the third place, the difficulty of ascertaining the precise balances of the Provincial Governments and the Central Government on any particular date arises from circumstances connected with the accounting system and will not be entirely solved, though it may be simplified to some extent, by the separation of the banking accounts.

(4) In the fourth place, some of the advantages claimed for the separation are of a fictitious nature. The provincial balances after the separation would presumably be kept with the Imperial Bank of India, which has branches all over India, and in actual operation the system would merely substitute the control of the Imperial Bank of India for the control by the Central Government. Centralisation would continue, but the amount saved by the present arrangements would be transferred to a private bank instead of being credited to the Central Government and set off against the cost of services which are rendered to the Provincial Governments and which would otherwise be charged for. To meet temporary deficits the Provincial Governments would be compelled to take advances from the bank or issue treasury bills. They would also have to make their own arrangements for remittances abroad through the bank. Even if it were admitted that, under the present system, the Central Government makes considerable profits, it might be argued that a more appropriate solution would be an apportionment of the cost on more rational lines among the various Governments rather than the adoption of a system that would result in the transfer of the profits to a private bank. It is also doubtful whether Imperial Bank would give more favourable terms as regards interest on deposits than those offered by the Central Government at present.

(5) In the fifth place, it is debatable whether the system would lead to a higher sense of financial responsibility in Provincial Governments and Legislatures. Members of the Legislature even in the advanced countries of Europe ordinarily take no interest in the intricate financial operations that are necessary for the carrying on the ordinary day-to-day administration. The problems of ways and means, resource and remittances are dealt with by specially trained officers. The seperation in India would probably involve the initiation of a few provincial officers into the mysteries of higher finance, but it is doubtful whether anything more would be achieved.

75. The question of the separation of banking accounts was discussed at the

annual Conferences of Financial Representatives held in 1922, 1923 and 1924. The general view of the representatives in 1924 was that the necessity for an immediate change had not been proved. It was recognised generally that the separation of banking accounts was not a matter in which it was essential to move quickly and that it was not necessary to introduce the change simultaneously in all the provinces. The Reforms Enquiry Committee, which examined the working of the constitution in 1924, recommended the separation of Central from Provincial balances as an essential preliminary to an appreciable advance towards provincial autonomy. The Government of India accepted this recommendation, but were of opinion that the change could not be introduced at a moment's notice and that the new system must be slowly evolved with all possible caution. They considered that the immediate action to be taken on the recommendations of the Reforms Enquiry Committee should be limited to an extension of the experiment already undertaken with a view to the separation of provincial accounts from audit, which was regarded as essential before the balances could be separated.

G.—SEPARATION OF AUDIT FROM ACCOUNTS.

76. It will be observed from the description of the financial machinery given in Section E that under the present constitution the Auditor General is not only responsible for the audit of Government transactions but is also entrusted with the compilation of the Finance and Revenue Accounts of India which are annually presented to Parliament. In order to enable him adequately to discharge this function, he has been invested by statutory rules with the power of prescribing the forms in which accounts should be kept by the combined audit and accounts staff under him. The actual work of compilation and consolidation is, it has been noticed, done in almost all the provinces by a Central staff under the Accountant-General except in the case of certain Departments. The Auditor General is also required by statutory rules to make arrangements for the supply of any information derivable from the accounts that may be required by Provincial Governments and to render them such assistance as may be necessary in the preparation of the annual budget estimates. In practice, the Accountant General advises the Provincial Government unofficially on questions of leave, allowances, pay, etc., and also criticises departmental estimates in the light of past actuals.

77. The system is thus in important respects different from that in force in England where the Comptroller and Auditor General is reponsible only for audit. Moreover, in England, to each of the great Departments which has financial functions to perform there is attached a financial staff and an accounting Department, the head of the Department, who is the Chief Accounting Officer, being held responsible for the maintenance of accounts, including an internal check of transactions. The system generally followed in India has in practice resulted in considerable inconvenience, and its defects have been pointed out in the Memorandum submitted to the Statutory Commission by the Government of the United Provinces. The more important of these are briefly summarised below :—

(1) In the first place, the system of sending bills in batches from the treasuries to a head office for classification, check and audit before they are passed into the accounts has caused great delay in the preparation of the accounts, which are seldom ready for several weeks after the close of the monthly transactions. This has made it exceedingly difficult for the heads of Departments to

control their expenditure, since they are not in a position to find out what their expenditure was on a particular date until about two months later. The system, moreover, discourages expenditure of money towards the end of the year and consequently unnecessarily large sums have lapsed every year.

(2) In the second place, since the auditor himself compiles the accounts, the audit of accounts has been of a perfunctory character.

(3) In the third place, since the Accountant General has no knowledge of the working of the Departments whose estimates he criticises, his scrutiny is merely mechanical and based on past actuals. In the absence of any close control of expenditure the system encourages overbudgetting on the part of Departments.

78. To remove these defects, the separation of accounts from audit was suggested in 1923. The question was first raised by the Indian Retrenchment Committee, who considered it purely from the point of view of Central expenditure. They pointed out that under the present rules the Provincial Governments could demand from the Auditor General any information derivable from accounts without paying for it. They considered that the separation of accounts from audit would enable the Central Government to relieve itself of a portion of the expenditure which it now incurs in connection with the maintenance of accounts or, at any rate, it would prevent Provincial Governments from demanding information relating to accounts that would involve unduly large expenditure from Central revenues. A scheme for the provincialisation of accounts was worked out in 1923 and put into practice in the United Provinces as an experimental measure. After a period of trial in two Departments, it was brought into force in all the Departments in these Provinces with effect from the 1st April 1926. The principal features of the new system are described in paragraph 99 of the Memorandum submitted by the Government of the United Provinces, which is quoted below for facility of reference :—

" (1) To each department is attached a pay and accounts office, the head of which is known as pay and accounts officer. He is a gazetted Government servant of the status of an assistant accounts officer in the Indian Audit and Accounts department. The larger

departments (Public Works department, Land Revenue, General Administration, Administration of Justice, Education and Police) have each an accounts office and officer of its own; the smaller departments, arranged in convenient groups, share such an office and officer.

(2) These offices are located where possible in the office of the head of the department, or at all events in the same place and in convenient proximity to him.

(3) Bills against the various departments are no longer presented at the treasury but sent to the pay and accounts officer concerned. He preaudits the bill and then pays it by cheque, subsequently passing the charge into the departmental accounts which he compiles.

(4) Provincial accounts are maintained in a central accounts office which is under the immediate charge of a deputy chief accounting officer of the status of a first class officer of the Indian Audit and Accounts department, and in superior charge of the chief accounting officer, who is the finance secretary. This officer also deals with various accounts that cannot be easily departmentalised: for instance, loans and advances, exchange accounts, etc. The deputy chief accounting officer further acts as pay and accounts officer for the forest department.

(5) The pay and accounts officers prepare the revised and budget estimates in the same way and on much the same lines as the former accountant general. They subsequently send them to the finance department, which examines and passes them and subsequently prints the detailed estimates.

(6) To each accounts office is attached an audit section, the duty of which is to examine its accounts. These audit sections are under a central officer, namely the director of audit. He also has staff sufficient to send out into the districts to inspect accounts there. Bills are no longer examined at the treasuries, which have become merely counters where moneys are actually paid or received."

79. The advantages claimed for the system, which are also described in the

Memorandum submitted by the United Provinces Government, are as follows :—

(1) It is stated that, under the new system, departmental accounts instead of being two months late are now ready within a fortnight of the end of the month to which they refer, and consequently heads of departments do not experience any difficulty in ascertaining the progress of their expenditure and in controlling it.

(2) Audit under the new system is entirely independent of accounts and inasmuch as the accounting staff is an expert staff the amount of routine work that devolves on audit is greatly diminished. It is argued that the audit staff under the new system ought to be able to devote itself to more important enquiries and investigations.

(3) The Pay and Accounts Officer, being attached to a single Department, is conversant with its needs and difficulties and prepares its budget and revised estimates accordingly.

(4) Controlling officers are no longer tempted to leave margins and this renders more accurate budgetting possible.

(5) Finally, the Provincial Government having to maintain its own accounts is made to entertain a greater sense of responsibility and has an ampler scope in directing its administration.

80. The system has been worked with great enthusiasm by the Government of the United Provinces with the assistance of a specially selected staff, and it is stated that the experiment has on the whole proved a success. It is, however, a question for consideration whether the advantages claimed for the system could not be obtained without a complete provincialisation of accounts. The following points might be noted in considering the question whether the system should be adopted universally in India :—

(1) In the first place, the advantages of a preaudit, so far as the Provincial Departments are concerned, may be overrated. It is stated that it functions best where there is least possibility of leakage under the old system. It is debatable whether it is very effective in the case of contingent expenditure and whether it can be universally applied to works expenditure where leakages most frequently occur. It has not been

found practicable to introduce it in the Public Works Department of the United Provinces, though it is understood that the system of pre-audit has been applied to big public works in a restricted area (*e.g.*, the Lloyd Barrage Scheme of Bombay).

(2) In the second place, as regards the speedy compilation of accounts for the use of heads of departments and the avoidance of excesses or savings in budget allotments, it might be pointed out that the head of the department has relatively little interest in the progress of expenditure during the first six months of the financial year. He is vitally concerned in expenditure between October and February. In October he has to forecast his supplementary requirements for the current year and frame his budget for the next year. The old type of Accountant General's office has generally been re-organised on a departmental basis and there is nothing to prevent a weekly compilation of accounts provided the local Government pays for special staff for the purpose. The cost of such staff would be only a fraction of the total extra expenditure which universal separation would entail.

(3) In the third place, separation would indubitably be expensive. The accounts officer requires as many men as the older Accountant General's office contained and the specialised audit staff is approximately one-third of the accounts office. It is estimated that the system will involve an additional expenditure of at least Rs. 3 lakhs per annum in the major provinces. It is argued that separation of balances might make good this extra cost to Provincial Governments, but it seems clear that so far as the Central Government and the Provincial Governments taken as a whole are concerned, there must be extra expenditure ; nor is the separation of balances essential for the separation of accounting from audit.

(4) In the fourth place, under the new system there is a certain amount of duplication of audit proper. The account offices exercise an internal check which is as extensive as under the former system, but owing to the necessity for quick payments, have to concentrate only on essentials. The

super-imposed audit staff does an intensified check of the audit done in the accounts offices. It is claimed that the new system gives more time to the audit staff for what has been described as 'higher' audit, *i.e.*, enquiries and investigations into the system of expenditure with reference to broad principles such as those indicated in the canons of financial propriety. It might be argued, however, that for the efficient conduct of higher audit the staff is more disadvantageously placed than before. The audit staff proper is debarred from daily touch through correspondence with executive officers and cannot readily appreciate the complexities of practical problems and if, as has been suggested, local inspections were also entrusted to accounting offices, audit's contact with the realities of administration would be gone. It might also be argued that the men best fitted to make enquiries into the system of expenditure are executive officers independent of the Provincial Government and experienced in the practical work of the Departments and not officers of the Audit Department who cannot claim a living knowledge of administrative affairs.

(5) Another danger is the possibility of the executive bringing undue influence to bear on the accounts officers, who under the new system will be entirely provincial officers directly under the control of the Provincial Government. The number of departments to which it would be necessary to attach these accounts officers is so large that normally these officers would be of a status lower than that of the All-India Services or even that of the Indian Audit and Accounts Service. It is doubtful whether these subordinate officers would be in a position to check extravagance and to criticise the executive on whom their promotion depends. There is also the possibility that in certain circumstances these officers under pressure from the executive might be tempted to conceal facts from the audit officers.

H.—(CO-ORDINATION.)

81. Co-ordination of provincial activities is primarily an administrative problem and the justification for mentioning it here lies partly in the fact that such co-ordination may be more necessary in the region of finance than in other spheres of administration and partly in the fact that in most other countries the control necessary for the purpose of ensuring co-ordination is exercised through the medium of the grant-in-aid. The necessity for co-ordination in financial matters arises from the fact that monetary operations are in most countries concentrated in one or more large industrial or commercial centres. The question of co-ordination in respect of provincial borrowing, ways and means operations, resource arrangements, remittance arrangements, etc., has been dealt with in the preceding section and a brief reference may now be made to the problems that have arisen in the administration of other services.

82. The history of the administration of many of the more advanced countries of the world, particularly those constituted on a federal basis, reveals a distinct tendency towards a co-ordination of the activities of the constituent provinces or states, especially in matters which are of more than provincial importance. A few instances relating to Canada and Australia are given below by way of illustration :—

(1) *Canada.*—Although roads are essentially a State matter under the Canadian constitution, the Dominion Parliament, in the interests of the country as a whole, found it necessary to pass the Canadian Highways Act in 1919, which authorised the expenditure of $20 millions during the following five years for the purpose of constructing and improving the highways of Canada. A grant of $80,000 was made to every Province during each of the five years, the remainder being allotted in proportion to their respective populations. The co-operation and encouragement of the Dominion Government has done much to raise the standard of road maintenance throughout the country.

(2) Educational administration is entirely a Provincial matter under the constitution, but the Dominion Government, realising the national importance of vocational education, has found it necessary to supplement the Provincial funds available for these purposes. In 1913 the Agricultural Instruction Act was passed distributing $10

millions in ten years among the Provinces for the advancement of agricultural education. In 1919 a similar sum was voted for technical education, which was distributed among the Provinces approximately on a population basis subject to the condition that the Provinces spent at least as much on technical education out of their own revenues. This has given a great impetus to the development of vocational education particularly, it is stated, in the eastern manufacturing Provinces.

(3) Public health administration is also in the hands of the Provincial Governments in Canada, but the Dominion Parliament has, by an Act passed in 1919, created a Dominion Council of Health which co-ordinates the activities of the Provincial administrations. It meets twice a year to discuss health problems which are of interest to all the Provinces and, as a result of its efforts, there is now greater uniformity in the standards of public health administration.

83. Even in Australia, where the States have always been jealous of any interference in administrative matters by the Commonwealth Government, there is a distinct tendency towards centralisation and co-ordination of State activities :—

(1) Inter-State conferences in matters of education are held frequently.

(2) The Commonwealth Government has undertaken the supervision of the treatment for venereal diseases and grants a subsidy of £15,000 per annum to the various States for the provision of hospital treatment for persons suffering from these diseases.

(3) Under the Institute of Science and Industry Act of 1920, the Commonwealth Government is required to establish—

(*a*) a bureau of agriculture,

(*b*) a bureau of industries, and

(*c*) such other bureaux as the Governor General determines.

Power is also given for the establishment of a general advisory council and advisory boards in each State to advise the Director in regard to the general business of the Institute and any particular matter of investigation or research. Under the Act, the Director is required to co-operate, so far as is possible, with existing

State organisations in the co-ordination of scientific investigation.

84. So far as India is concerned, the problem of co-ordination in matters of public health, communications, etc., has already arisen. It is the subject of a separate Memorandum submitted to the Statutory Commission and it is therefore not proposed to discuss it here in detail. The question of subsidies or contributions to Provincial Governments for purposes of co-ordination is dealt with in the next section of this Memorandum

I. (CONTRIBUTIONS TOWARDS THE ADMINISTRATION OF INDIVIDUAL SUBJECTS)

85. The constitutional and legal propriety of contributions from the Central revenues in aid of Provincial subjects and from Provincial revenues in aid of Central subjects has been questioned on more than one occasion since the introduction of the reformed constitution. The Committee on the Division of Functions recognized the difficulties involved in working out a complete scheme of classification of Central and Provincial subjects and in paragraph 14(4) of their report they remarked as follows with reference to the scheme recommended by them :—

> "It must, however, be remembered that in this case we are not attempting a division of powers which will be subject to test in the courts, and we can therefore with greater confidence leave the effect of the division proposed to be worked out in the course of legislative and administrative practice in the light of accepted general principles. Our scheme has been devised on such a basis as to leave the way open for this process of development."

The Joint Select Committee accepted with certain alterations the classification suggested by the Functions Committee subject to the following general observations :—

> "It must not, however, be concluded that these partitions of the functions of Government are absolutely clear-cut and mutually exclusive. They must in all cases be read with the reservations in the text of the Functions Committee's report and with due regard to the necessity for special procedure in cases where their orbits overlap."

In cases in which the Central Government employs the agency of the Provincial Government for the administration of a Central subject the cost of the establishment is divided in the manner indicated in Devolution Rules 47 and 48. There are, however, no statutory rules regarding the apportionment of expenditure in cases in which the functions of the Central Government and Provincial Governments overlap, although such overlapping was recognised to be inevitable under the reformed constitution.

86. (In section 20(1) of the Government of India Act it is provided that the revenues of India shall, subject to the provisions of the Act, be applied to the purposes of the Government of India alone. The Devolu-

tion Rules made under section 45 A. of the Act effect a separation of the respective functions of the Central and Provincial Governments and a division between the Central and Provincial Governments of the revenues of India. The only rule which refers to contributions from the Central Government towards the administration of Provincial subjects is Devolution Rule 14 (1)(*e*) under which payments made to a local Government by the Governor-General in Council or by other local Governments *either for services rendered or otherwise* are classified as a source of provincial revenue. It has, however, been held that the words "or otherwise" in this rule cannot justify Central contributions towards the administration of Provincial subjects unless they are definitely in the nature of payments for services rendered. Indeed, from the constitutional point of view, the continuance of such contributions has been viewed as subversive of the whole structure of the division of revenues between the Government of India and the Provinces affected by the Act. This explains the foot-note to the Central Audit Resolution issued by the Secretary of State in Council regarding the financial powers of the Governor General in Council. It runs as follows :—

> "Since the enactment of the Government of India Act 1919 and of the Devolution Rules, it is not permissible to incur expenditure from Central revenues on Provincial subjects or to make assignments from Central to Provincial revenues for expenditure on a Provincial subject."

87. A different view, however, has been held as regards the propriety of Provincial contributions towards the administration of individual Central subjects. It was considered that Central expenditure on Provincial subjects was objectionable, because under such a practice there was a danger of the revival of the old system of doles and the control associated with it. This consideration did not apply to Provincial assistance to Central subjects and it was contended that if a local Government believed and could induce its legislature to agree that Provincial outlay upon a Central subject was in the Provincial interest, there was nothing in the spirit of the Act which rendered such expenditure improper. In the absence of specific legal prohibition, a large number of such contributions has been permitted during the last eight years. Instances of these are :—

Bengal—

(*i*) Payment of an annual grant of Rs. 25,000 towards the cost of

maintaining the Victoria Memorial Hall.

(*ii*) Payment of the actual cost of establishment employed in the Art Section of the Indian Museum.

Assam—

Contribution for expenditure on establishment employed on Internal Emigration work.

Madras—

(*i*) Contribution of Rs. 8,000 for the investigation of Kala Azar.

(*ii*) Contribution of Rs. 10,000 to the Andamans Administration for the construction of a mosque.

(*iii*) Contribution of Rs. 2,000 to the Military Department in connection with demonstration march.

Bihar and Orissa—

(*i*) Contribution of Rs. 6,820 towards the cost of construction of the outpatient block of the hospital attached to the Pusa Agricultural Institute.

(*ii*) Annual contribution of Rs. 42,000 to the East Indian Railway Technical Institute at Jamalpur.

Bombay—

Proposed contribution of Rs. 5,000 towards expenditure on the erection of a Chatri over Shri Shivaji Samadhi at Raigarh.

Punjab—

Contribution from Provincial revenues for expenditure on the Aitcheson College, Lahore.

United Provinces—

(*i*) Contribution of Rs. 10,000 to Aligarh University.

(*ii*) Contribution to the Army Remount Department towards construction of a Stallion Depot at Meerut.

Central Provinces—

Contribution to the Chiefs' College, Raipur, paid during 1921-22 to 1923-24 but since discontinued.

Burma—

Contributions payable by the Burma Government for the conduct of survey operations in that province.

88. Doubts, however, have recently been expressed as to the legality of these contributions. It has been pointed out that there is no express provision either in the Government of India Act or in the Devolution Rules authorising such expenditure. Since both the Central and Provincial Governments can possess only such powers in this respect as are conferred on them by

the statute creating them or the rules made thereunder, it might be argued that neither Government is entitled to incur such expenditure.

89. From the administrative point of view, the prohibition of Central contributions towards Provincial subjects has also been found to be inconvenient. For instance, in 1925, when the question of financial assistance from Central revenues to the London School of Hygiene and Tropical Medicine, which affords facilities for the instruction of Indian students and officers of the Indian services, was under consideration, it was contended that the Government of India could not legitimately expend Central revenues in contributing to the School and that if a contribution on behalf of British India as a whole was to be made, the charge should be distributed between Central revenues and the revenues of each Governor's province in the proportion of the share of the benefit which was calculated to accrue to the provinces. The question of Central grants for provincial purposes has been dealt with elsewhere. It is a point for consideration whether, in certain cases such as those indicated below, Central contributions towards provincial expenditure and Provincial contributions towards Central subjects should not be permitted:—

(1) A provincial Government might be permitted to incur from Provincial revenues expenditure on a Central subject or might make payments from Provincial revenues to another Province if by incurring that expenditure or by making such payments it confers a benefit on its own Province.

(2) One Government might be permitted to pay another for services rendered or goods supplied. Expenditure incurred by one Government for the requirements and at the request of another, when such expenditure would not ordinarily have been incurred for its own requirements or in the discharge of its own responsibility, might be re-imbursed by the latter.

(3) The Government of India might be permitted to incur expenditure for the purposes of co-ordinating the activities of Provincial Governments in cases in which such co-ordination is essential in the interests of India as a whole.

J.—FAMINE INSURANCE.

90. Famine expenditure was recognised as an Imperial charge until the year 1875 when the doctrine was first enunciated that though it was the duty of the State to preserve the lives of the people, the primary responsibility for providing for their own support ought to rest upon the people themselves. The theory of the division of responsibility for this class of expenditure was laid down in the following terms in 1877 :—

> "Distress should be met from local resources so far as is possible; district resources should only be responsible when local resources fail; provincial resources when district resources fail; and Imperial resources last of all."

Partly owing to its lack of definition and partly owing to the limited nature of local and district resources, this principle was not applied in practice to any appreciable extent, though famine expenditure was formally provincialised in the settlement of that year. For nearly 30 years the cost of famine relief was actually met from provincial revenues so long as they were able to bear the burden and thereafter it was accepted as a charge upon Imperial revenues.

91. In 1878-79, what is commonly known as the Famine Insurance Fund was established by the Government of Lord Lytton. The great famines which had ravaged India between 1874 and 1878 had involved an expenditure of over Rs. 14 crores and a review of the effect of this heavy expenditure had revealed the fact that it had in reality been defrayed from loan funds, the ordinary revenue of the country just sufficing to meet the normal expenditure of the Government. Since famine was at that time an ordinary incident of the Indian administration (there were about two famines in every ten years), the Government of India came to the conclusion that it was financially unsound to depend on loans for meeting such charges. They accordingly decided to strengthen their financial resources by one million sterling recurring revenue per annum, which was estimated to be the average amount which the Central revenues might be called upon to provide against the cost of periodical famine in supplement of the expenditure on famine relief incurred from provincial funds. The required amount was raised by means of a famine cess levied upon land and a license tax imposed upon persons following particular trades. The object of the Fund was "by increasing the revenue to avoid constant additions to the debt of India

which the prevention of periodical famine would entail either by applying that increase of income to works likely to avert famine and thus obviate famine expenditure or by reducing annually the debt contracted for famine, so that if the famine expenditure should again become inevitable, the reduction of debt made in years of prosperity would compensate for the liabilities incurred during a scarcity."* The Fund, however, did not escape, during periods of financial stringency, the fate of other similarly situated funds. Almost immediately after it was instituted it was raided to meet the expenditure arising out of the Afghan War. It was again applied to other purposes during Lord Dufferin's administration and the annual contribution was reduced to Rs. one crore by Sir James Westland, who justified the reduction on the ground that there was an improvement in the economic condition of the country and in the capacity of the people to resist famine. It was restored to the original figure by Lord Curzon.

92. For several years after the establishment of the fund, the surplus funds which remained after actual expenditure on famine relief during the previous year had been met were applied to the reduction of old debt. The Government of India, however, were at that time borrowing largely for productive purposes and they soon recognized that there was nothing to be gained by paying off old loans and incurring new debts simultaneously. It was therefore decided that, so long as borrowing continued, the surplus in the Famine Insurance Fund should be appropriated to the avoidance of new rather than to the liquidation of old loans. The administration of the Fund was briefly on the following lines:—

(*a*) Out of the annual provision of Rs. 150 lakhs, the actual expenditure during the year on famine relief was first met,

(*b*) The surplus was partly utilised for the construction of protective irrigation works and railways, and

(*c*) the balance was applied to the avoidance of new debt or the reduction of old debt.

93. It will thus be seen that although in theory famine expenditure was Provincial, in practice large sums were contributed by the Central Government out of the so-called Famine Insurance Fund described above. The stage, however, at which the burden shifted from the Provincial to the Imperial account was wholly indefinite and no provision was made for the cost of famine relief in fixing

*Report of the Parliamentary Committee appointed in 1879 presided over by Lord George Hamilton.

the standards of expenditure in Provincial settlements. In view of the many serious objections urged to the system, a new famine scheme was devised in 1906, by which the Government of India placed to the credit of each Province exposed to famine out of the Famine Insurance Fund a fixed annual amount which could be utilized in case of famine without drawing on its normal resources. A maximum of these annual credits was also fixed for each Province with reference to its liability to famine, the maximum expenditure which it incurred during a year on famine and the conditions as regards railway communications and irrigation facilities under which its famine administration would be conducted in the future. When the amount accumulated by this process was exhausted, further expenditure was shared equally by the Central and Provincial Governments and in the last resort the Central Government gave the Province further assistance from their own revenues.

94. In 1917 the arrangement described above was modified and famine relief became a divided head, the expenditure being apportioned between the Central and Provincial Governments in the proportion of 3 : 1, which coincided approximately with the actual incidence under the system introduced in 1906. The Famine Insurance Funds, however, continued to exist and an annual provision of Rs. 1½ crores was made in the budget up to the introduction of the Reforms.

95 Such was the position when the question of provincial settlements was examined by the Meston Committee. Under the new distribution of the sources of revenue suggested by this Committee, a net increase was expected in the spending power of the provinces aggregating Rs. 18,50 lakhs, on which, as has been described elsewhere, the Committee assessed the initial contributions to be paid by the Provincial Governments to the Central Government to meet the deficit in the Central Account resulting from the introduction of the new system. In determining the increase of spending power, the expenditure relating to famine relief and the construction of protective irrigation works, which had been made Provincial under the Reforms Scheme, was deducted from the normal revenue of each Province. In the case of expenditure on famine relief, an average was taken of the expenditure in each province for a period of 20 years (1896-1916), while as regards protective irrigation works similar averages were taken for a period of ten years (1907-17). The reason for the adoption of a different period in the latter case was that it was thought that in the

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case of famine relief expenditure it was proper to take figures over a period representing an average cycle of varying seasons, whereas in the case of protective irrigation works it was more suitable to have a shorter period representing expenditure under more recent conditions. According to this calculation the average expenditure on famine relief and protective irrigation works amounted to :—

	(In thousands of rupees.)
Madras	6,61
Bombay	63,60
Bengal	2,00
United Provinces	39,60
Punjab	3,81
Burma	67
Bihar and Orissa	11,62
Central Provinces	47,26
Assam	10

On the above basis a new system of provision for famine expenditure was evolved as follows. Every Provincial Government was required by Devolution Rule 29 to establish and maintain out of provincial revenues a Famine Insurance Fund in accordance with the principles laid down in Schedule IV to the Devolution Rules. Each Provincial Government was required to contribute to its own fund for famine insurance, an annual contribution on the scale indicated in the statement above. This annual contribution was to be devoted in the first instance to the construction of protective works and if necessary to relief measures, the sum not required for those purposes being utilised in building up a balance in the Famine Insurance Fund. The balance at the credit of the Fund was regarded as invested with the Central Government which pays interest on it at a rate one per cent. less than the rate charged for advances made by the Central Government to the Provincial Loans Fund. The Fund *i.e.*, both the annual contributions and the accumulated credits were available for application whenever necessary either for actual famine relief or for construction of protective works or for the grant of advances to cultivators.

96. It may be observed that the surplus credits in the Central Famine Insurance Fund that remained after meeting the annual expenditure on famine relief was upto 1921 utilised by the Government of India for the reduction of their ordinary debt, only a very small fraction, if any, of which was incurred for purposes of famine relief. There

was in reality no separate fund in existence. Even after the introduction of the Reforms, no separate Fund has been created, the annual assignments of the Provinces being merged in the general balances of the Government of India. Since these balances are largely utilised for financing the capital programme of the Government of India and for advances to the Provincial Loans Fund, one result of the present system is, as has been pointed out in the section of the Memorandum relating to Provincial Balances, that the amounts which are contributed by the provinces to the Famine Insurance Fund are in practice re-lent to them at a rate of interest which is one per cent. higher than the rate at which interest is allowed on the balances in the Fund.

97. The principal criticism directed against the new arrangements introduced under the Reforms was that in the case of certain provinces (Bombay, the United Provinces and the Central Provinces), the assignments had been pitched too high. In 1926, therefore, the Government of India examined the question of revising the constitution of the Famine Insurance Fund and the regulations governing it. A review of the famine expenditure in the 20 years 1905-1925 showed that under greatly improved conditions due to the development of irrigation and communications and increased prosperity in the general community a considerable reduction could be effected in the contributions required to be made to the Fund without endangering the objects for which it was created. The figures also revealed that in another direction the system required revision. The rules then in force did not compel any province to maintain a minimum balance for meeting expenditure on famine relief proper; and from this cause in certain cases the annual contribution had been heavily drawn upon for irrigation works, the strictly protective character of which was open to some doubt and little had been accumulated to meet the direct demands of a really bad season or series of seasons. The Government of India, therefore, in consultation with the Provincial Governments formulated certain proposals for the re-constitution of the Fund on a different basis, the principal features of which are as follows:—

(1) The famine fund should provide solely for expenditure on famine relief proper and the financing of protective irrigation works should be undertaken by the Province as part of the ordinary administration.

(2) The annual contribution was recalculated with reference to the average amounts spent annually on famine relief proper during the period 1905 to 1925.

(3) The financing of loansto cultivators should hereafter be carried out by means of advances from the Provincial Loans Fund.

98. One effect of these proposals, which have been approved by the Secretary of State in 1928, as a tentative measure, has been a substantial reduction in the Provincial contributions to the Famine Insurance Fund and consequently in the maxima amounts required to be accumulated. The assignment of Bombay has been reduced from Rs. 64 lakhs to Rs. 12 lakhs, of the United Provinces from Rs. 40 lakhs to Rs. 16 lakhs, of the Central Provinces from Rs. 47 lakhs to Rs. 4 lakhs and of Bihar and Orissa from Rs. 12 to Rs. 3 lakhs.

APPENDIX I TO SECTION D.

SUGGESTED SCHEME FOR THE CONSTITUTION OF A BODY OF NATIONAL DEBT COMMISSIONERS IN INDIA.

1. The principal funds deposited with the Government of India on which interest is paid are as follows :—

	Balance on 31-3-26. (In crores of Rs.)
(1) Special loans and treasury notes—	
These are various old endowments on which the Government have guaranteed payment of interest rates varying from 3½ to 8 per cent.	1·69
(2) Service Funds—	
These are not under the control of Government, but they have been deposited with them at favourable rates of interest varying from 5¼ to 6 per cent.	1·55
(3) Provident Funds—	
of which the principal are—	
(*a*) The State Railways Provident Fund,	
(*b*) Company Railways Provident Fund,	
(*c*) General Provident Fund and the	
(*d*) I. C. S. Provident Fund—	
Contributions to these are compulsory for certain classes of Government servants and optional for others. In the case of Railways, the contributions of employees are supplemented from Railways funds. The rate of interest is fixed periodically, and the accumulated deposits with interest are paid to the employees on the termination of their service..	40·42
(4) Postal Insurance and Life Annuity Fund—	
Interest is allowed at the rate of 3½ per cent. on the balance in the Fund	2·65
(5) Post Office Cash Certificates—	
Interest is paid in the shape of a bonus which works out on an average to about 5 to 6 per cent. per annum compound interest	20·96
(6) Post Office Savings Bank Balances—	
Interest is allowed at 3 per cent	27·23
(7) Railway Depreciation Fund—	
Interest is allowed at 3½ per cent.	5·74

(8) Railway Reserve Fund—	
Interest is allowed at 3¾ per cent.	9·32
(9) Posts and Telegraphs Depreciation Fund—	
Interest is allowed at 3¾ per cent.	·33
(10) Famine Insurance Fund—	
which consists of Provincial contributions made under statutory rules—	
Interest is allowed at 3¾ per cent.	4·82
(11) Depreciation Fund of commercial Departments under the Government of India—	
Except in the case of the Northern India Salt Revenue Department, no interest is paid on these deposits ..	·13
	114·84

The departmental and judicial deposits of the Central and Provincial Governments have been excluded, partly because no interest is paid on them and partly because it would be extremely difficult to hand over these deposits to a body such as the National Debt Commissioners for investment.

2. Practically the whole of this amount (Rs. 114·84 crores) is now included in the Government of India's balances and interest is credited on these deposits at a rate which is either fixed in advance or which varies from time to time with the variations in the rate at which Government can borrow in the open market. The greater portion of the amount, if not the whole, is normally utilised for financing the large capital programmes of the Central Government and the Provincial Governments. The system is open to serious objections which are briefly indicated below—

(*a*) Under this system money has to be borrowed whether it is wanted or not. From the practical point of view, however, this objection is not serious so long as the Government has a large capital programme in hand.

(*b*) As worked at present, Government pays on money lent to it at a time when interest rates are low, not the low rate of interest that it would pay for a long term loan issued in the market at such a period but a short term rate varying with the conditions of the market which may rise and has, in fact, risen high in recent years.

(*c*) Government undertakes the liability of paying out a portion of the money to depositors (for example, advances from Provident Funds) at uncertain intervals, but this liability is ignored in fixing the rate of interest.

(*d*) The position is also unsatisfactory from the point of view of the depositor, who is forced to accept a rate

of interest based on short term deposit rates which frequently is demonstrably less favourable than terms which he could secure for himself if he were at liberty to invest the money, which he does not expect to require for a long time, in some long period security.

3. These defects arise mainly from the fact that there is no body corresponding to the National Debt Commissioners in England to whom these Funds could be handed over by the Government for investment. It is therefore proposed that a similar body might be constituted in India on the following lines :—

(1) It would consist of

(*a*) a Managing Governor of the Imperial Bank of India,

(*b*) a representative of the Railway Board,

(*c*) a legal adviser, possibly the Advocate General of Bengal or Bombay,

(*d*) two representatives of Government servants to be nominated by Government (when Provident Funds are under consideration), and

(*e*) the Controller of the Currency.

(2) To this body would be transferred all monies in the Government balances in India described in paragraph 1 above, except the Post Office Cash Certificates and the Post Office Savings Bank deposits. The inclusion of these last two items would involve considerable administrative difficulties. It is therefore proposed to exclude them for the present.

The monies would be transferred in the shape of Government of India stock, the precise nature of which would have to be determined at a later stage.

(3) The management of the Provincial Loans Fund would be transferred to the proposed Board. The liabilities of this Fund on the 31st March 1926 amounted to 114·59 crores and the interest paid amounted to 5·21 crores The average rate of interest was 4·54 per cent. The whole of this debt could be given the form of 4½ per cent. Provincial loans stock issued to the Government of India on such terms as to yield the same amount in interest as the total amount of interest payable by the Provinces on their debt to the Government of India. If the management were transferred to this body, it would, of course, be possible for it to invest a considerable portion of its surplus money in this stock.

(4) The class of security in which the Commissioners could invest their money in future would be subject to the approval of the Government. This would necessarily vary according to the nature of the Fund.

(5) As regards Provident Funds, the relations between Government and the contributors to the Funds so far as guarantee of capital, repayment, etc., are concerned, would remain the same as at present. In other words, the Commissioners would only be an investing body and the present guarantee as regards depreciation of capital, etc., would continue. The Government would continue to do all the work in regard to receiving money from subscribers, paying out advances to them, etc, and also the keeping of accounts. The cost of keeping the accounts, would, however, be debited to the Funds.

(6) Separate accounts would be kept for the different Funds so as to exhibit clearly the contribution of the tax-payer to the Service Funds on which a favourable rate of interest is paid.

(7) A minimum rate of interest (say 4 per cent.) would be guaranteed by the Government. At the end of every year the liabilities to the subscribers would be compared with the value of the assets in the hands of the Commissioners in order to determine whether there is a surplus or a deficit. A portion of the surplus, if any, would be transferred to a reserve fund to provide for any contingent liability under the guarantee against depreciation and the remainder credited proportionately to the accounts of the subscribers.

(8) Since the class of securities in which the Board could invest their surplus money would depend on the nature of the Fund, it would be necessary to maintain separate accounts for different classes of Funds. For instance, a separate account would be maintained for the Provident Funds, another for the Railway Reserve and other depreciation funds and so on.